

Message Text

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SUBJ: CENTRAL BANK INTERVENTION IN BANKING GROUP

1. SUMMARY: ON APRIL 16, 1974, CENTRAL BANK OF BRAZIL ANNOUNCED THAT IT HAD INTERVENED IN THE HALLES BANKING GROUP, ONE OF BRAZIL'S LARGER AND MOST AGGRESSIVE GROUPS OF FINANCIAL INSTITUTIONS. THE GROUP CONSISTS OF 5 INSTITUTIONS: COMMERCIAL BANK, INVESTMENT BANKS, FINANCE COMPANY, EXCHANGE BROKER, AND STOCK BROKER. THE MEASURE WAS TAKEN UNDER RECENTLY PASSED LEGISLATION (LAW 6024 OF MARCH 13, 1974) WHICH PERMITS CENTRAL BANK TO TAKE SUCH ACTION TO ENSURE THE LIQUIDITY AND STABILITY OF FINANCIAL SYSTEM. THE PRACTICAL RESULT OF MEASURE IS THAT ALL LIABILITIES OF BANKING GROUP ARE SUSPENDED FOR INDEFINITE PERIOD, WHICH MAY BE UP TO ONE YEAR. REASONS FOR INTERVENTION GIVEN BY MONETARY AUTHORITIES HAVE SO FAR BEEN VERY GENERAL, WITH EMPHASIS ON PREVENTIVE NATURE OF ACTION. FINANCE MINISTER HAS STATED THAT THIS WAS AN EXCEPTIONAL MEASURE WHICH WILL BE REPEATED ONLY IF IT BECOMES NECESSARY FOR THE WELL-BEING OF THE ECONOMY.

2. BANKING COMMUNITY IN GENERAL SUPPORTS THIS MEASURE BECAUSE IT WILL HAVE SALUTARY LONG-TERM EFFECTS ON THE SYSTEM.

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FOR SOME TIME RUMORS HAVE BEEN CIRCULATING THAT

THE HALLES GROUP WAS IN DIFFICULTY. NO DOUBT MANY BANKERS CAN NOW BREATHE A SIGH OF RELIEF, ALTHOUGH OTHERS WHO HAVE BEEN PRACTICING SOME OF THE IRREGULARITIES OF HALLES MAY BE WORRYING. OUR CONGENS IN RIO AND SAO PAULO HAVE GATHERED THE FOLLOWING BACKGROUND INFORMATION ON THE INTERVENTION. END SUMMARY.

3. HALLES GROUP HAS LONG HAD REPUTATION OF A LOOSE OPERATION. DURING PAST SIX MONTHS OR SO IT HAS BEEN RUMORED TO HAVE HAD SERIOUS LIQUIDITY PROBLEMS CAUSED LARGELY BY ITS RAPID EXPANSION, POOR ADMINISTRATION, AND GENERAL MARKET LIQUIDITY SQUEEZE. HALLES COMMERCIAL BANK LIQUIDITY RE-DISCOUNTS AT CENTRAL BANK HAD ALLEGEDLY GROWN TO THREE TIMES BANK'S NORMAL LEGAL LIMIT.

4. MUCH OF THIS LIQUIDITY PROBLEM APPARENTLY GENERATED BY GROUP'S OWN PRACTICES. ITS COMMERCIAL BANK REPORTEDLY ACCEPTED TIME DEPOSITS FOR FIXED PERIOD AND SIMULTANEOUSLY ISSUED "ILLEGAL" LETTERS PROMISING TO SURRENDER THE DEPOSITS IN ADVANCE OF THE CONTRACTED DATES IF CLIENTS SO REQUIRED. MOREOVER, THESE DEPOSITS WERE SUPPOSEDLY PAID EXTREMELY HIGH INTEREST RATES. WHEN GENERAL MARKET LIQUIDITY CONTRACTED AFTER AUGUST 1973, CLIENTS BEGAN WITHDRAWING THEIR DEPOSITS, THEREBY AGGRAVATING BANK'S LIQUIDITY PROBLEM. SIMILARLY, HALLES TRADING COMPANY HAD ALLEGEDLY ISSUED LOANS TO SOYBEAN TRADERS WITHOUT RECEIVING ADEQUATE COLLATERAL, CAUSING COMPANY TO SUFFER SUBSTANTIAL LOSSES WHEN NOTES WERE NOT PAID AS SCHEDULED.

5. HALLES GROUP APPARARENTLY USED SEVERAL MEANS, IN ADDITION TO THOSE MENTIONED ABOVE, TO EASE ITS LIQUIDITY POSITION. IT REPORTEDLY EXCEEDED CENTRAL BANK INTEREST RATE LIMITES IN ORDER TO ATTRACT DEPOSITORS. IT SHOULD BE NOTED, HOWEVER, THAT THIS PRACTICE HAS BECOME FAIRLY WIDE-SPREAD. OTHER PRACTICES WERE CONSIDERED FAR MORE SERIOUS. FOR EXAMPLE, THE GROUP SUPPOSEDLY MISUSED FOREIGN BORROWING PROCEDURES, OBTAINING LOANS ABROAD FOR "DUMMY" COMPANIES AND CHANNELLING FUNDS TO ONE OF THE HALLES GROUP FIRMS. SECON, IT "SOLD" (I.E., USED AS COLLATERAL) ITS DEPOSITORS' TREASURY BILLS IN ORDER TO OBTAIN FUNDS IN THE OVERNIGHT MONEY MARKET. IF THIS CHARGE IS CONFIRMED, BANK OFFICIALS WOULD PRESUMABLY BE LIABLE FOR CRIMINAL PROSECUTED OFFICIAL USE

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TION.

6. PROJECTIONS ARE THAT INVERVENTION WILL LAST SIX TO TWELVE MONTHS. GOVERNMENT EXPECTED TO PERMIT WITHDRAWAL OF SMALL DEPOSITS AND PAYMENT OF SMALL BUSINESS ACCOUNTS WITHIN RELATIVELY SHORT PERIOD. BANKING AND BROKERAGE OPERATIONS, MEANWHILE, SERIOUSLY DISRUPTED BY OUTSTANDING HALLES CHECKS AND COMMERCIAL PAPER. GOVERNMENT EXPECTED TO SANITIZE HALLES GROUP AND THEN

SELL IT BEFORE TERMINATING ITS INTERVENTION. ANY LOSSES INCURRED DURING THIS PROCESS WILL BE COVERED BY REQUIRED RESERVES AND, IF NECESSARY, BY SHAREHOLDERS. CENTRAL BANK EXPECTED TO PREVENT FOREIGN CREDITORS FROM SUFFERING ANY LOSSES.

7. SOME LOCAL BANKERS BELIEVE THIS INTERVENTION SIGNALS NEW, TOUGHER OFFICIAL POLICY DESIGNED TO CURB LOOSE OPERATION OF COMMERCIAL BANKS AND THEIR RELATED FINANCIAL INSTITUTIONS. ADDITIONAL INTERVENTIONS MAY OCCUR.

8. EMBASSY COMMENT: INTERVENTION BY CENTRAL BANK IN HALLES GROUP SHOULD NOT BE SEEN AS MAJOR WEAKNESS OR AS PORTENDING MAJOR DIFFICULTIES FOR BRAZIL'S FINANCIAL SYSTEM. THE BANKING SYSTEM HAS TRADITIONALLY OPERATED UNDER GENERAL GUIDELINES WITHOUT DETAILED LEGAL REQUIREMENTS OR VERY CLOSE GOVERNMENT SUPERVISION. NEVERTHELESS, THE SYSTEM HAS OPERATED FAIRLY EFFECTIVELY AND EFFICIENTLY. SELF-DISCIPLINE HAS WORKED, BECAUSE OF ITS POOR MANAGEMENT AND LIQUIDITY PROBLEMS, THE HALLES GROUP STRETCHED THE RULES BEYOND PERMISSIBLE BOUNDS, FORCING GOVERNMENT INTERVENTION. WITH THIS LATEST ACTION, THE CENTRAL BANK HAS CLEARLY SIGNALLED ITS DESIRE THAT THE BANKING COMMUNITY ADOPT A MORE CONSERVATIVE OPERATING STYLE.

9. ONE OUTCOME OF THE HALLES INTERVENTION MAY BE AN INCREASE IN THE INTEREST RATE STRUCTURE. THE CENTRAL BANK IS QUITE AWARE THAT BANKS HAVE BEEN HAVING DIFFICULTY IN ATTRACTING SUFFICIENT FUNDS AT THE OFFICIALLY SET RATES AND THAT THE LIQUIDITY PROBLEM WAS GROWING. WE UNDERSTAND THAT THE CENTRAL BANK IS NOW TAKING A CLOSE LOOK AT INTEREST RATES AND MAY ANNOUNCE AN INCREASE DURING THE NEXT FEW DAYS. WE AGREE WITH OBSERVATION NOTED ABOVE THAT MONETARY AUTHORITIES WILL TRY TO PREVENT FINANCIAL LOSSES TO FOREIGN CREDITORS AND THUS AVOID ANY ADVERSE IMPACT ON BRAZIL'S INTERNATIONAL CREDITWORTHINESS.

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CRIMMINS

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